Managers' Internal Control Program Conference

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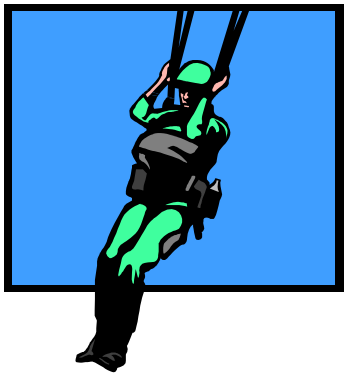
Internal Control References

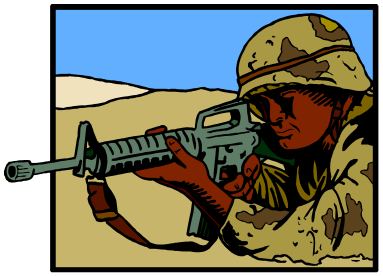
- DoD Website: http://www.dod.mil/comptroller/fmfia/index.html
- Federal Managers' Financial Integrity Act of 1982 (PL 97-255)
- OMB Circular A-123, Management's Responsibility for Internal Control, August 5, 2005 (Recently revised)
- DoD Directive 5010.38, Management Control Program, 26 August 1996 – (Under revision)
- DoD Instruction 5010.40, Management Control Program Procedures, 28 August 1999 (Under revision)
- Guidelines for Preparation of the Federal Managers' Financial Integrity Act Annual Assurance Statement – November 8, 2005
- GAO Standards for Internal Control in the Federal Government, November 1999

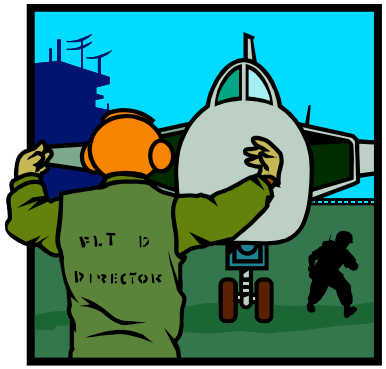
Agenda

- **Our Challenge -- Communicating the Importance of Internal Controls**
- **DoD FY 2005 Statement of Assurance**
- **DoD Scorecard Introduction, FY 2005 Results, and Improvements Achieved**
- **DoD Performance Goals**
- **FY 2006 Scorecard Criteria**
- **Recent Changes to OMB Circular A-123, Effective FY 2006**
- **Summary**

The Nature of Our Work Demands That We…..
<u>Be in Control</u>!!

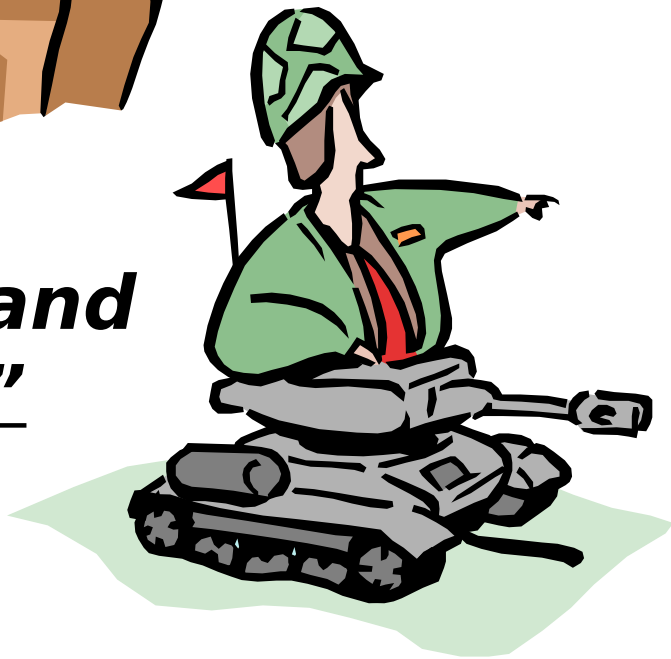




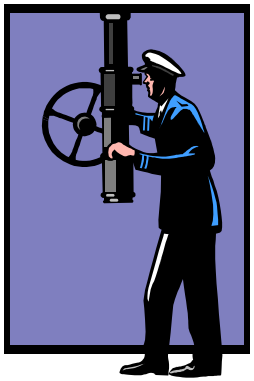


Leaders Know That They Must…
Be In Control!!

“Command and <u>Control</u>”



In Fact, Most DoD Personnel Understand … Be In Control!!



OUR MISSIONS ARE RISKY!!

Remember What Happens When We've … Lost Control?

Or Everything Is …
Out of Control?

So Why Is It SO HARD To Communicate

the Importance of Establishing and Maintaining

Internal Controls??

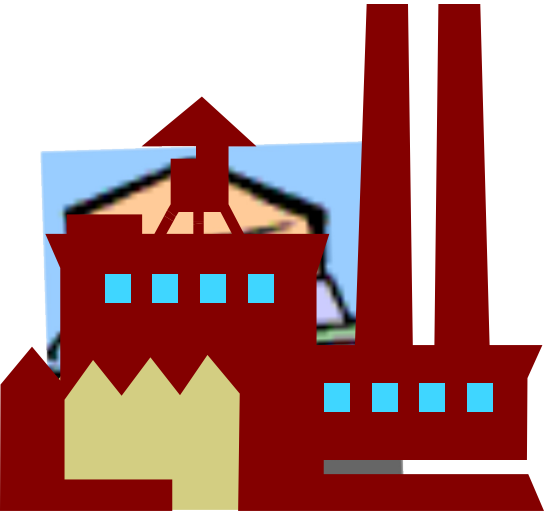
Perhaps Because…..

Internal Controls Are Perceived As –

- A bean-counter, financial or auditing function
- Too administrative, not operational
- Not critical to mission accomplishment
- Not important to the warfighter
- A paperwork exercise

How do we better communicate the importance of effective internal controls

Example Where Ineffective Controls Adversely Affect Both Operations and Financial Statements ....



Factory

Foxhole

Operational Concern

- Inadequate supply quantities to meet deployed forces needs (certain items)
- Inadequate management of shipping containers
- Inadequate protection at the distribution centers causing pilferage
- Inadequate visibility over equipment / supplies transported from factory to foxhole

Financial Statement Concern

- Inability to properly value inventory on financial statements

Public Relations (PR) Campaign

- DoD is developing a PR Campaign:
  - Raise awareness on the importance of effective internal controls
- Target Audience:
  - DoD Leadership:
    - Senior Civilian and Military Leaders
    - DoD Managers and Supervisors
  - DoD Managers' Internal Control Program Coordinators
  - All DoD Personnel
- Key Themes:
  - Defense needs better awareness to help reduce situations where you have to ask, "How could that have happened?"
  - Leadership is ultimately responsible, but all personnel must help
  - Senior leadership must demonstrate commitment
  - Training is essential
- Strategy:
  - Develop slogan – such as example "Be in Control"
  - Develop ways to communicate our message with universal appeal

Need assistance to raise awareness at Components

DoD FY 2005 Statement of Assurance

Federal Managers' Financial Integrity Act (FMFIA)
Applies to All Programs and Operations

Managers will:

- Establish an effective system of internal controls
- Assess the effectiveness of internal controls
- Annually report assurance
  - Identifying material weaknesses
  - Describing plan and schedule for correcting

- (Unqualified) – "reasonable assurance that management (internal controls) are in place, effective, and being used."
- (Qualified) – "reasonable assurance that management (internal) controls are in place, effective, and being used except for…"
- (No Assurance) – "does not provide reasonable assurance."

Results FY 2005
Material and Systemic Weaknesses

- **Significantly Improved – Reduced 47 FMFIA weaknesses to 34**
- **<u>Overall Weaknesses in Internal Controls (Section 2)</u>**
  - **46 Weaknesses Beginning of FY 2005**
    - **22 Corrected (22 Material, 0 Systemic)**
    - **10 New (8 Material, 2 Systemic)**
    - **1 Transferred to Non-DoD Agency**
  - **33 Weaknesses Remaining at end of FY 2**
    - **11 Systemic**
      - **2 New**
    - **22 Material**
      - **8 New**

Internal Control = tool, plan, process that helps ensure, but does not guarantee mission accomplishment.

- **Material** = Affecting single Component
- **Systemic** = Affecting multiple Components

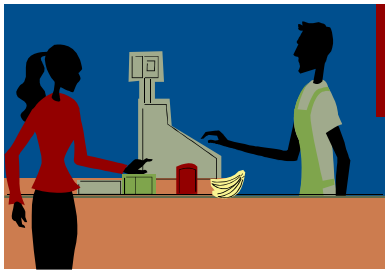
Results FY 2005
Material and Systemic Weaknesses (Continued)

- **Financial Weaknesses in Internal Controls (Section 2)**
  - **17 Weaknesses Beginning of FY 2005**
    - **8 Corrected (8 Material, 0 Systemic)**
    - **4 New (4 Material, 0 Systemic)**
  - **13 Weaknesses Remaining at end of FY 2005**
    - **5 Systemic**
    - **8 Material**
- **Financial System Nonconformance Weakness (S 4)**
  - **1 Ongoing**

Internal Control = tool, plan, process that helps ensure, but does not guarantee mission accomplishment.

- **Material** = Affecting single Component
- **Systemic** = Affecting multiple Components

DoD Scorecard Introduction, FY 2005 Results, and Improvements Achieved



Statement of Assurance Scorecard… Why Score?

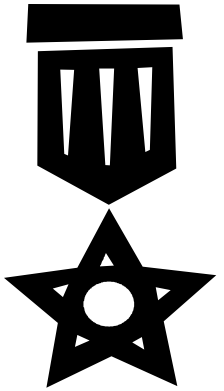
- Began in FY 2003
- Help improve DoD Components' reporting performance in five categories – And it's working!!
- Provide constructive feedback to Components
- Recognize top performers
- Improve timeliness so DoD can prepare and report on time

Five Scorecard Categories… What Scored?

- Timeliness (points for early and timely reporting)
- Format (points for well-written reports requiring no revision)
  - Accurate, complete, easy to read
  - Compliance with Directive, Instruction, and Annual Guidance
  - No revisions required because revisions risk timely reporting
- Component-wide program execution (points for evidence of methods used to improve program execution)
- Component-wide training (points for evidence of different types of training and to whom)
- Material weakness reporting (points for prompt resolution of weaknesses and evidence that assessments were conducted)
  - Percentage of weaknesses corrected on time
  - If no weaknesses reported, evidence of robust assessment used

Scorecard…
Components Receiving High Scores

- First Place
  - Defense Logistics Agency
  - Department of the Air Force
  - Department of the Navy
- Second Place
  - Defense Finance and Accounting Service
- Third Place
  - Defense Commissary Agency
  - Defense Intelligence Agency
  - Pentagon Force Protection Agency
  - US Special Operations Command
- Fourth Place
  - National Defense University
  - National Security Agency
  - Office of the Secretary of Defense (Consolidated Statement)
  - US Pacific Command
  - US Strategic Command



Most Improved!!

- Defense Finance and Accounting Service
- Defense Logistics Agency
- Defense Security Cooperation Agency
- Defense Security Service
- Department of the Navy
- Office of the Inspector General
- US Central Command
- US European Command
- US Joint Forces Command
- US Pacific Command

Scorecard Total Results

Agency	Timely	Format	Program Execution	Training	Material Weaknesses Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
Defense Logistics Agency	Green	Blue	Blue	Blue	White	Blue	3.2	+1.6
Department of Air Force	Green	Blue	Blue	Blue	White	Blue	3.2	+0.4
Department of Navy	Green	Blue	Blue	Blue	White	Blue	3.2	+1.4
Defense Finance and Accounting Service	Green	Blue	Blue	Green	White	Blue	3.0	+1.6
Defense Commissary Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	+0.2
Defense Intelligence								

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

Scorecard Total Results (Cont)

Agency	Timely	Format	Program Execution	Training	Material Weakness Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
Pentagon Force Protection Agency	Blue	Blue	Blue	Blue	Green	Green	2.8	+0.4
US Special Operations Command	Blue	Blue	Blue	Blue	Green	Green	2.8	+0.2
National Defense University	Blue	Green	Blue	Blue	Green	Green	2.6	+0.8
National Security Agency	Green	Blue	Blue	Blue	Green	Green	2.6	0.0
Office of the Secretary of Defense, Consolidated Principal Staff & Field Activities	Green	Blue	Blue	Blue	Green	Green	2.6	-0.2

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = 0

Scorecard Total Results (Cont)

Agency	Timely	Format	Program Execution	Training	Material Weaknesses Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
US Pacific Command	Blue	Green	Green	Green	Purple	Green	2.6	+1.6
US Strategic Commend	Blue	Green	Blue	Blue	Green	Green	2.6	+0.4
Defense Information Systems Agency	Green	Green	Blue	Blue	Green	Green	2.4	+0.6
Defense Security Cooperation Agency	Blue	Amber	Green	Green	Purple	Green	2.4	+.1.0
Joint Staff	Green	Blue	Green	Blue	Green	Green	2.4	0.0
Missile Defense Agency	Green	Green	Blue	Blue	Green	Green	2.4	0.0

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

Scorecard Total Results (Cont)

Agency	Timely	Format	Program Execution	Training	Material Weaknesses Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
National Geo-Spatial Intelligence Agency	Blue	Green	Blue	Green	Green	Green	2.4	+0.4
Inspector General	Blue	Green	Blue	Green	Green	Green	2.4	+1.0
US Southern Command	Blue	Green	Green	Blue	Green	Green	2.4	+0.2
US Transportation Command	Green	Green	Blue	Blue	Green	Green	2.4	+0.6
Defense Advanced Research Projects Agency	Blue	Blue	Green	Green	Amber	Green	2.2	0.0

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

Scorecard Total Results (Cont)

Agency	Timely	Format	Program Execution	Training	Material Weaknesses Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
Defense Contract Audit Agency	Blue	Green	Green	Green	Green	Green	2.2	+0.4
Uniformed Service University of the Health Sciences	Blue	Green	Green	Green	Green	Green	2.2	+0.4
Defense Contract Management Agency	Blue	Green	Green	Green	Amber	Green	2.0	+0.8
Defense Threat Reduction Agency	Green	Green	Green	Green	Green	Green	2.0	+0.6

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

Scorecard Total Results (Cont)

Agency	Timely	Format	Program Execution	Training	Material Weakness Reporting	FY 2005 Color Score	FY 2005 Overall Score	Change from FY 2004 Overall Score
US Central Command	Green	Green	Green	Green	Green	Green	2.0	+1.6
US Joint Forces Command	Blue	Green	Green	Green	Amber	Green	2.0	+1.0
US Northern Command	Green	Green	Green	Green	Green	Green	2.0	+0.6
Defense Security Service	Green	Amber	Green	Red	White	Amber	1.8	+1.0
US European Command	Green	Green	Green	Amber	Green	Amber	1.8	+1.6
Department of the Army	Red	Green	Amber	Blue	Red	Red	0.8	-0.4

Point Values: White = 5, Purple = 4, Blue = 3, Green = 2, Amber = 1, and Red = -1

FY 2005 Statement of Assurance Improvements

Red = Unacceptable
Amber = Needs improvement
Green = Acceptable
Blue, Purple & White = Exceptional (receiving extra credit) points

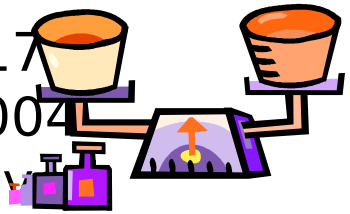
- Percentage On Time:
  - 97% in FY 2005 (31 of 32)
  - 88% in FY 2004 (30 of 34)
  - 48% in FY 2003 (15 of 31)
- Percentage 7 days ahead of Suspense:
  - 50% in FY 2005 (16 of 32)
  - 18% in FY 2004 (6 of 34)
  - 10% in FY 2003 (3 of 31)
- Percentage of Weaknesses Completed:
  - 48% in FY 2005 (22 of 46)
  - 28% in FY 2004 (11 of 40)
  - 36% in FY 2003 (25 of 70)
- Eight of 10 delinquent weaknesses resolved

Delinquent Weakness Defined As:

- **Identified in FY 2000 or before, <u>and</u>**
- **Correction target date slipped more than twice, <u>and</u>**
- **Target date slipped 3 years past original target date**

Department of Defense Performance Goals

- Metric = # (%) material / system weaknesses resolved
- Financial Goal = zero material or systemic weaknesses
  - Reduced from (17 to 13) or 24%
  - 0% reduced in FY 2004
- Non-Financial Goal = 100% resolved as projected & reduce delinquent weaknesses to zero
  - 71% were corrected as projected (12 of 17)
  - Compares to only 43% corrected in FY 2004
  - Eight of ten delinquent weaknesses resolved
- Department encourages full disclosure
- We must promptly resolve weaknesses as projected



MUCH IMPROVEMENT OVER LAST FISCAL YEAR!!!

Scorecard Criteria for FY 2006

Statement of Assurance
~ Timely Category ~
FY 2006 Possible Scores

Blue	+3 pts	• Received on or before August 25, 2006 by close of business (COB)
Green	+2 pts	• Received after August 25, 2006 or by COB on September 4, 2006
Amber	+1 pt	• Received after September 4, 2006 or by COB on September 6, 2006
Red	-1 pt	• Received after September 6, 2006 or by COB on September 15, 2006
Black	**-10 pts**	• Received after September 15, 2006

NEW!

Pts = points received or lost

Statement of Assurance
~ Format Category ~
FY 2006 Possible Scores

Blue

+3 pts

- Best in Category -- Exceptional in all aspects (Accurate, complete, easy to read and represents a good model to benchmark)

Green

+2 pts

- No revisions required and not necessary to ask for explanation from Component

AND

- Acceptable in all aspects (Accurate, complete, easy to read, and represents an acceptable model)
- Returned for correction or requested Component to clarify an aspect of the statement intent

Amber

+1 pt

OR

- Unsatisfactory in at least one aspect (Not accurate, not complete, not easy to read, or does not represent an acceptable model)
- Extensive changes required

OR

Red

-1 pt

- Incorrectly stated the opinion, i.e. provided an unqualified statement that should have been qualified

OR

- Statement is noncompliant in one or more aspects (Component failed to follow provided guidance in preparing statement.)

Pts = points received or lost

Statement of Assurance
~ Program Execution Category ~
FY 2006 Possible Scores

Blue

+ 3 pts

- Best in Category – Component reports at least one innovative measure **that has not been previously reported** to enhance Component-wide program execution

BUT

- Excludes any Component that scored RED in the Material Weakness Category

Green

+ 2 pts

- Statement clearly indicates that Managers' Internal Control Program (MIC) is executed at all levels (Component–wide program execution)
- Statement has limited evidence of Component-wide program execution

Amber

+1 pt

- No evidence of Component-wide program execution in statement

OR

Red

-1 pt

- Statement is over 15 days late (Late submission reflects poor program execution

Pts = points received or lost

Statement of Assurance
~ Training Category ~
FY 2006 Possible Scores

Blue + 3 pts	• Best in Category -- Component reports at least one innovative measure **that has not been previously reported** which enhances training of the Managers' Internal Control (MIC) Program Component-wide
Green + 2 pts	• Evidence in statement of Component-wide MIC Program training performed for Component managers, MIC Program coordinators, and assessable unit managers
Amber +1 pt	• Statement reflects training for different Component audiences but not all as listed for Green score
Red -1 pt	• Statement provides no evidence of Component-wide MIC Program training

Pts = points received or lost

Statement of Assurance
~ Material Weakness Reporting Activity Category ~
FY 2006 Scores

White

+5 pts

- 85% or more of weaknesses corrected on time in FY 2006 as targeted in FY 2005 Statement of Assurance. (There must be at least 2 weaknesses corrected.)

OR

- 70% or more are corrected on time and at least two weaknesses are corrected in advance of target

Purple

+4 pts

- 80% or more of weaknesses corrected on time. (There is no qualification on the number that must be corrected.)

OR

- 60% or more are corrected on time and more than one weakness corrected in advance of target

Blue

+3 pts

- 75% or more of weaknesses are corrected on time. (There is no qualification on the number that must be corrected.)

OR

- 50% or more are corrected on time and at least one weakness corrected in advance of target

Pts = points received or lost

Statement of Assurance
~ Material Weakness Reporting Activity Category ~
FY 2006 Scores (continued)

Green

+ 2 pts

- 60% or more are corrected on time

OR

- If none due for correction in FY 2006:
  - At least one new weakness reported or one weakness reported as corrected in last three years

    OR
  - Statement indicates at least two deficiencies found, that do not warrant reporti as material weaknesses and statement describes actions to resolve them (Mus use format described on page 13, para s., Part I, Annual Guidance)
- 50% or more corrected on time

OR

Amber

+1 pt

- If none due for correction during FY 2006 and no new or old weaknesses in last three years, the statement of assurance must indicate at least one deficienc and actions to resolve it (Must use format on page 13, para s.)
- No weaknesses reported as new in past three years

AND

- ~~No weaknesses corrected in past three fiscal years~~

AND

Red

-1 pt

- No deficiencies with corrective actions discussed in the statement

Pts = points received or lost

Statement of Assurance
~ Material Weakness Reporting Activity Category ~
FY 2006 Scores (continued)

- One or more delinquent weakness(es) will result in a REDUCTION OF TOTAL SCORE for the Material Weakness Reporting Activity Category as follows:
  (A Component with any remaining delinquent weaknesses would receive the next lower score in the total score of this category. For example, a Component which resolved 3 of 4 or 75% of the weaknesses on time would usually receive a Blue score of 3 points. However, if that Component also had one or more delinquent weaknesses remaining open, the total score would be reduced by one color resulting in a Green score of 2 points.)

EXAMPLE

Material Weakness Reporting Activity Category

Component scores BLUE, but has one uncorrected *Delinquent Weakness*

Therefore Component Score Reduced to GREEN

Pts = points received or lost

Recent Changes

to the Managers' Internal Control Program Due to Revisions in the OMB Circular A-123

Recent Changes to OMB A-123

Effective Beginning FY 2006

	Major OMB Circular A-123 Changes
1	Changes term “management controls” to “internal controls”
2	Stresses managers’ responsibility and role for effective internal controls
3	Realigns to five Government Accountability Office Standards (GAO) (1999)
4	Adds new concepts: -- Design & operation deficiencies -- Reportable conditions -- Material weakness over financial reporting
5	Retains same process for assessing and reporting assurance on internal controls for program, administrative, and operation activities (FMFIA Overall)
6	Requires separate assurance statement for internal controls over financial reporting (ICFR) as subset to FMFIA Overall Assurance Statement
8	Prescribes process for assessing, testing, and documenting internal controls over financial reporting (Appendix A)
7	Requires a DoD senior assessment team (SAT) for ICFR only (Appendix A)
9	Adds requirement to improve accountability and effectiveness of Government Card Programs (Appendix B)

Changes to DoD Managers' Internal Control Program FY 2006 Annual Guidance

1. Changes term "management controls" to "internal controls"

- Definition of internal controls same as management controls
- Management (internal) controls are the process that helps ensure mission objectives are met:
  - Helps ensure accountability
  - Does not guarantee success or ensure against waste, fraud, or mismanagement, but helps mitigate RISK
- Three objectives of internal controls:
  - Effective and efficient operations
  - Reliable financial reporting
  - Compliance with applicable laws and regulations

2. Stresses managers' responsibility and role for effective internal controls

- More emphasis on managers' responsibility and role
- Performance management indicators for DoD Component:
  - Senior Responsible Officials
  - Assessable Unit Managers
  - Senior Official assigned for each material or systemic weakness

Changes to DoD Managers' Internal Control Program FY 2006 Annual Guidance (Cont)

3. Realigns to five Government Accountability Office Standards (GAO) (1999)

- Control Environment
  - Integrity and ethical values
  - Commitment to competence
- Risk Assessment
  - Identify mission objectives
  - Identify risks (qualitative and quantitative)
- Control Activities
  - Policies, procedures, techniques, mechanisms
  - Diverse activities (i.e., approvals, authorizations)
- Monitoring
  - Ongoing process, or
  - Separate evaluation
- Information and Communication
  - Reliable, relevant, and timely information

4. Adds New Concepts

a. "Design and Operation Deficiencies"

Example

Risk = Unauthorized access
Control = Electronic lock on the door

Control Deficiency = unauthorized entry occurs

Was entry due to a design or operation deficiency?

Design Deficiency = Weak Design of lock

Operation Deficiency = Lock Design good but not used

Changes to DoD Managers' Internal Control Program FY 2006 Annual Guidance (Cont)

4. Adds New Concepts (continued)

b. "Reportable Condition"

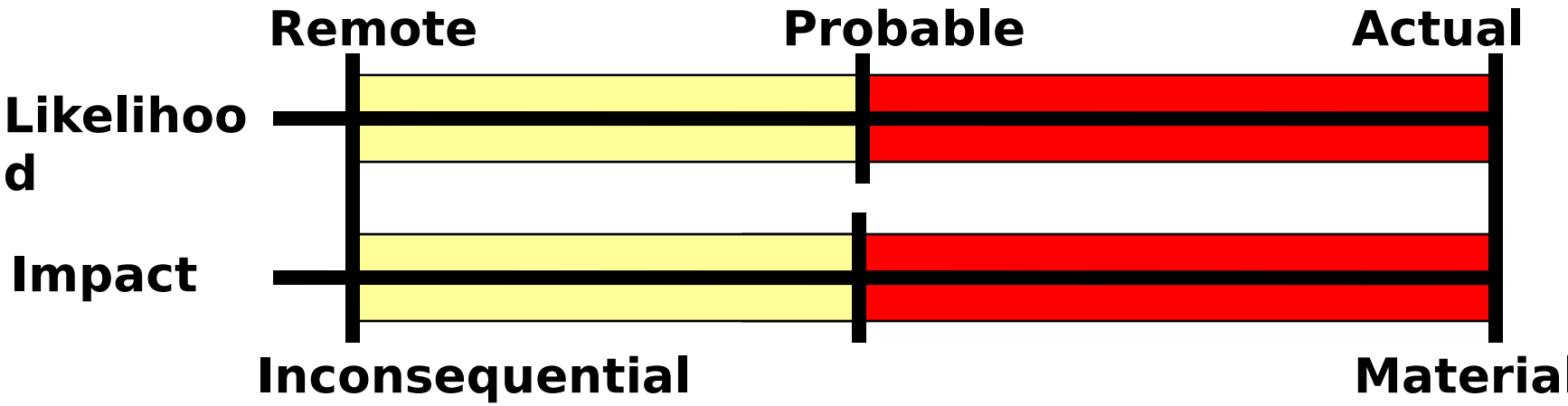
- <u>For Internal Controls FMFIA overall</u>:
  Deficiency that could adversely affect the ability to meet mission objectives.
- <u>For Internal Controls over Financial reporting</u>:
  Deficiency that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles so that there is more than a remote likelihood that a misstatement of the entity's financial statements, that is more than inconsequential, will not be prevented or detected.
- **Not reported outside organization**
- But tracked for correction internally

4. Adds New Concepts (continued)

c. "Material Weakness"

- <u>For Internal Controls FMFIA overall:</u>
  Reportable condition that Component Head considers significant enough to report outside of the Component.
- <u>For Internal Controls over Financial reporting:</u>
  Reportable condition that results in more than a remote likelihood that a material misstatement of the financial statements, or other significant financial reports, will not be prevented or detected.
- **Reported to next higher level**
- Tracked at the Secretary of Defense level and managed by the USD(C)

Reportable Condition versus Material Weakness



Changes to DoD Managers' Internal Control Program FY 2006 Annual Guidance (Cont)

5. Retains same process for assessing and reporting assurance for program, administrative, and operation activities (FMFIA Overall)

- By Sep 1st, provide Secretary of Defense:
  - Assurance Statement on internal controls over all:
    - Programs
    - Administrative Activities
    - Operations
- Statement is "as of date signed"

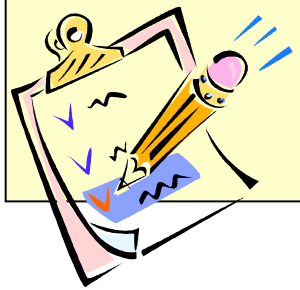
6. Requires separate assurance statement over financial reporting as subset to FMFIA Overall Assurance Statement

- By Sep 1st, provide Secretary of Defense Assurance Statement over financial reporting as subset to FMFIA Overall
- Only applies to DoD Components with:
  - Financial Statement Reporting Entities required by DoD or OMB to produce stand alone statements, or
  - Components listed in the DoD annual guidance
- Statement is "as of June 30"

Changes to DoD Managers' Internal Control Program FY 2006 Annual Guidance (Cont)

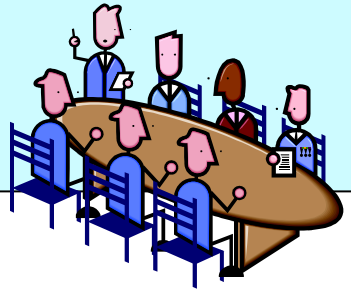
7. Prescribes process for assessing, testing, and documenting internal controls over financial reporting (Appendix A)

- Unlike FMFIA Overall, the FMFIA over Financial Reporting:
  - Will use TOP DOWN approach
    - DoD Senior Assessment Team (SAT) will oversee by:
      - Annually setting focus areas (what to assess)
      - Providing Defense-wide oversight of the process



8. Requires a DoD Senior Assessment Team (SAT) for internal controls over financial reporting only (Appendix A)

- Financial statement reporting entities (FSRE) must also establish a SAT:
- FSRE SATs will design and monitor all assessments and closely follow:
  - DoD SAT
  - OMB A-123, Appendix A
  - DoD Annual Guidance
  - Chief Financial Officers Council Implementation Guide



Changes to DoDManagers' Internal Control Program FY 2006 Annual Guidance (Cont)

9. Adds requirement to improve accountability and effectiveness of Government Card Programs (Appendix B)

- Use procedures of FMFIA Overall for assessing, documenting, and reporting

Summary

- **Communicating the importance of internal controls:**
  - **Is one of our biggest challenges**
  - **Is the driving force for the upcoming Defense-wide awareness campaign**

- **Requirements for OMB Circular A-123 have expanded:**
  - **Appendix A – Financial Reporting**
  - **Appendix B – Government Card Program**

- **Senior leaders' roles and responsibilities:**
  - **Are being re-emphasized**

- **DoD Managers' Internal Control Program:**
  - **Has changed to meet revised OMB requirements**
  - **Is gaining in leadership's attention, emphasis and support**
  - **Has improved through use of a scorecard**